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SUBJECT: INVESTING IN ALGERIA NOT FOR THE FAINT OF HEART

REF: A. ALGIERS 01123
¶B. ALGIERS 00708

¶1. (SBU) SUMMARY: A soon-to-be-released report by the World Bank uses polling data to rank the main challenges facing the private sector in Algeria. Among the key obstacles detailed in the study were credit access and cost, the role of the informal market, access to land, and taxation. The broader issues of transparency and access to capable human resources have also impeded foreign investors. The study's findings track well with the experience of U.S. firms over the last few years seeking to play a role in Algeria's fledgling private sector. END SUMMARY.

EXCHANGE CONTROLS, ACCESS TO CREDIT

¶2. (SBU) With a stranglehold by state-run financial institutions, major foreign exchange controls and the virtual absence of capital markets, Algeria's financial sector is perhaps the most underdeveloped in the region (ref A). Repatriation of profits is one of the biggest obstacles facing foreign investors. Foreign companies profits' are taxed 25 percent before they can be repatriated. Since the Algerian central bank must approve all foreign exchange transactions, our business contacts tell us that foreign companies must then wait often up to eight weeks for transfers that the Algerian government promises will be complete in four days. Numerous American food and service franchises as well as international consultancies have eyed the Algerian marketplace over the last few years but chosen not to invest because Algeria does not allow any repatriation of dividends from services. French franchises, of which there are a handful, have circumvented these restrictions by under- and over-invoicing as a means of remitting profits to France.

¶3. (SBU) Archaic or non-existent credit analysis techniques effectively block credit access for those who lack political connections or an already established relationship with entrenched, state-dominated business interests. While foreign investors are not mandated to work with a local agent, not doing so effectively closes the door to domestic financing. Business community contacts have told us that

lenders' risk aversion to doing business with foreigners has increased in the last few years following the banking scandals that brought down Khalifa Bank and a handful of other financial institutions. An Algerian firm that has served for over two decades as the local agent for a major U.S. flooring material firm told us recently that it has been unable to obtain financing to purchase raw materials from the U.S. company -- even though it's needed for a contract with the Algerian government -- because it lacks sufficient clout with Algerian banks. Embassy Algiers FCS is working with the firm and Ex-Im Bank to keep the project on track. Meanwhile, there is a sense in the American business community that the upcoming privatization of Credit Populaire d'Algerie, one of Algeria's largest state-run banks, will be the litmus test of whether meaningful financial reform will finally move forward.

INFORMAL MARKETS

¶4. (SBU) Foreign investors have made some headway against the glut of both counterfeit and legitimate products that are smuggled into Algeria. Proctor & Gamble hired an anti-counterfeiting consultant to work with Algerian customs to enhance its inspections. The result was a drop in the share of counterfeit P&G products in the Algerian market from around 60 percent in 2001 to 20 percent today. Black and Decker effectively reduced the number of counterfeit products by opening authorized B&D shops throughout Algeria. The struggle for Dunlop Tires was not so much counterfeit products as the influx of real tires through informal channels. Through outreach to Algerian customs, it reduced the market share of illegally imported tires from 50 percent

to about 15 percent over the last few years. Other companies have not fared as well. Wrigley's chewing gum pulled out of a USD 40 million investment after it was unable to reduce the plethora of products coming through informal channels, estimated at 90 percent of the Algerian market. Imported generic products have sharply reduced American pharmaceutical companies' profits in Algeria.

ACCESS TO LAND

¶5. (SBU) Perhaps oddly given that Algeria is Africa's second largest country in terms of geographic size, access to land for industrial development is a huge hurdle, according to nearly all our Algerian and many American business contacts. Part of the problem stems from Algeria's lack of port capacity and the fierce competition to During Algeria's decades-long experiment with socialism after independence, the government took control of the vast majority of the national territory. Aside from holdings by the elites, private land ownership was banned until 1989 as the country followed a series of Soviet-style five-year plans to allocate land for housing, industry, and agriculture. With the debut of economic reforms in the late 1980s, the Ministry of Environment and Territorial Planning took charge of the country's zoning and land redistribution. Would-be investors complain, however, that in practice access to land for industrial development depends on such factors as personal connections, payoffs to key decisionmakers and successful navigation of overlapping and byzantine bureaucracies. One Los Angeles-based firm with decades of experience building class A commercial real estate elsewhere described to us its efforts to develop office space in two up-and-coming industrial zones in metropolitan Algiers. After weeks of trying to contact the manager of the industrial development zone, the firm was told that it would have to talk to the wali (provincial governor) of Algiers, who in turn advised the company to address its request to the Ministry of Environment. Ultimately, none of the individuals consulted was able to make a decision on whether the firm could purchase land. Another U.S. firm is experiencing the same

challenges in acquiring land to build a glass production factory near Oran.

SHRINKING BUT SOMETIMES ARBITRARY TAXES

¶7. (SBU) Although the Algerian taxes exacted on foreign investors have dropped in the last few years and the government has tightened some loopholes, the capricious nature of the Algerian tax code hinders more robust foreign investment. Compared to other Maghreb countries, Algeria's taxes are relatively low and have been dropping over the last few years. Algeria's social security tax (26 percent) is higher than that of its neighbors but most of its tariffs are lower and its VAT and corporate profits taxes are lower than those in Tunisia and Morocco. Algeria closed a loophole in its tax code that double-taxed dividends for offshore investors after initially trying to tax American International Group for its investment in Orascom's Djezzy mobile telephone network. Other cases have not ended as successfully. Algeria's imposition of "extraordinary profit" taxes on certain existing oil contracts, most notably that of Anadarko Petroleum, has delayed Anadarko's moving ahead with new investments. Moreover, the new oil profits tax sent ripples well beyond the hydrocarbon sector (ref B).

TRANSPARENCY IN TENDERING

¶8. (SBU) Transparency in tendering is a major problem that foreign investors expect will only worsen as Algeria embarks on a USD 100 billion national infrastructure program. The East/West Highway project, which was widely expected to be awarded to Bechtel, ultimately went to a Chinese and Japanese consortium at a price rumored to have included a substantial payoff to Algerian officials. Other bids disadvantage

American firms in particular due to the technical standards written into the project specifications. A project to rebuild Algeria's railway system was awarded to Germany's Siemens and France's Alcatel in 2006 after the tender documents were written specifically to EU standards over objections from U.S. firms including General Electric. American Science and Engineering similarly lost out to Siemens on a contract to provide X-ray machines to Algerian customs because the specifications were written to European standards. On another project, a German firm reportedly paid an Algerian official 500,000 Euro to have specs changed to European standards. In a more overt example, a Sonatrach subsidiary demanded a U.S. firm pay a 3 percent cash fee on a USD 8 million hydraulic pump contract. When the U.S. firm refused, the tender was ultimately awarded to a French/Algerian joint venture.

HUMAN RESOURCES

¶9. (SBU) While not cited specifically in the World Bank study, numerous American and Algerian firms have highlighted the difficulty in finding and retaining skilled human resources as a major impediment to further investment. Firms as varied as Microsoft, Honeywell and Brown and Root-Condor have highlighted to us the tremendous challenge in finding staff, whether clerical or technical, with sufficient French or English-language skills. Other firms have lamented the work ethic of their Algerian staff. Still others note that as soon as they are able to hire skilled workers, they are quickly poached by foreign employers.

COMMENT: A ROSE WITH MANY THORNS

¶10. (SBU) Despite the many challenges to doing business, not all experiences have been negative. Citibank, for example, is very profitable in Algeria and is expanding its presence.

Honeywell's manager also very pleased with their slowly growing business in the gas processing sector. Money can be made in Algeria, but it is not for the faint of heart nor for those looking for a quick turnaround on their investment. Personal connections, whether to help cut through red tape and secure credit or in the more pernicious domain of outright corruption, are critical to doing business. Some aspects, including the overall tax regime and the role of informal markets, seem to be improving. The archaic financial sector, still the least developed in the region, is on the cusp of moving forward with the impending privatization of Credit Populaire d'Algerie. Still, an element of uncertainty brought about by opaque and often arbitrary decisionmaking looms over the business climate and remains an obstacle to more robust foreign investment.
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